KETUA PENGARAH HASIL DALAM NEGERI A

v.

LUXABUILT SDN BHD

HIGH COURT MALAYA, KUALA LUMPUR B
MOHD ZAWAWI SALLEH J
[CIVIL APPEAL NO: R2-14-08-08]
17 MAY 2010

REVENUE LAW: *Income tax - Deduction - Incentive payments - Incentive payments paid to employee as remuneration for extra work and services - Whether incentive payment fully deductible under Income Tax Act 1967, s. 33(1) - Whether incentive payment amounted to bonus and therefore not deductable under Income Tax Act 1967, s. 39(1)(h)* C

The respondent, a private limited company had made an incentive payment of RM745,480 to its employees in the Year of Assessment 2000. The incentive payments represented remuneration for extra work and services. The incentive payment were part of the respondent's business strategy which was consistently and genuinely applied even before bonus restriction was re-introduced in 1998. The respondent paid salary, bonus and incentives to their employees. The incentive was given to employees for securing sales and collections and to promote a sales and revenue driven culture within the workforce irrespective of their actual duties. The incentive system was formalised at the meeting of the board of directors. The appellant had treated the incentive payment of RM745,480 as bonus and consequently disallowed a deduction of a sum of RM745,480 under s. 39(1)(h) of the Income Tax Act 1967 ('the Act') in respect of the said incentive payments. The Special Commissioners of Income Tax ('the SCIT') had held that the incentive payment of RM745,480 was not a bonus. Hence this appeal by the appellant by way of case stated pursuant to para. 34 of Schedule 5 of the Act. The issue for determination was whether the appellant was correct in treating the incentive payment of RM745,480 as bonus and consequently disallowing deduction under s. 39(1)(h) of the Act in respect of the said incentive payments or whether alternatively the incentive payments of RM745,480 were not bonus and were therefore fully deductible under s. 33(1) of the Act. D E F G H I

Held (dismissing the appeal with costs):

(1) In the circumstances of this case the incentive payments could not be regarded as bonus and were fully deductible under s. 33(1) of the Act. Whether or not a payment is a bonus is a question to be resolved in light of the relevant facts. In arriving at the conclusion that the incentive payments were made to the employees of the respondent for extra work and services provided by the employees and hence were not bonus payments, the SCIT had correctly applied the principles stated in the case of *Director General of Inland Revenue v. Highlands Malaya Plantations Ltd* that incentive payments are not "a boon or gift over and above what is normally due as remuneration to the receiver". (paras 17 & 18)

(2) The respondent paid "incentive payments" to its employees for securing sales and collections and to promote a sales and revenue driven culture within the workforce irrespective of their actual duties. This was the policy of the respondent which was formalised by the meetings of the board of directors. It was not difficult to see such a business strategy as "incentive" in that it rewarded the staff who had performed duties over and above what was required of them. (paras 22 & 23)

(3) There was sufficient evidence, both oral and documentary, before the SCIT in deciding that the recipients had performed duties over and above what was required of them and they expected payment for the same. (para 25)

Case(s) referred to:

Chua Lip Kong v. Director-General of Inland Revenue [1981] 1 LNS 157 PC ***(refd)***

Director-General Of Inland Revenue v. Highlands Malaya Plantations Ltd [1988] 1 LNS 145 SC ***(foll)***

Director-General Of Inland Revenue v. Harrisons & Crosfield (M) Sdn Bhd [1988] 2 CLJ 1; [1988] 1 CLJ (Rep) 34 SC ***(refd)***

HEH Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri [1995] 2 MSTC 2194

Lim Foo Yong Sdn Bhd v. The Comptroller-General Of Inland Revenue [1986] 2 CLJ 182; [1986] CLJ (Rep) 1 PC ***(refd)***

Lower Perak Co-operative Housing Society Berhad v. Ketua Pengarah Hasil Dalam Negeri [1994] 3 CLJ 541; [1994] 3 BLJ 265 SC ***(refd)***

Mamor Sdn Bhd v. Director-General Of Inland Revenue [1979] 1 LNS 145 ***(refd)***

Legislation referred to:
Income Tax Act 1967, ss. 33(1), 39(1)(h), Sch 5 para 34

For the appellant - Norsalwani; Lembaga Hasil Dalam Negeri
For the respondent - Vijey Krishnan; M/s Raja, Darryl & Loh

Reported by Amutha Suppayah

JUDGMENT

Mohd Zawawi Salleh J:

Introduction

[1] This is an appeal by the appellant by way of case stated (CS) pursuant to para. 34 of Schedule 5 of the Income Tax Act 1967 (the Act).

[2] The appeal relates to the deciding Order dated 7 August 2007 where the Special Commissioners of Income Tax (SCIT) decided as follows:

> Adalah diputuskan bahawa bayaran insentif kepada pekerja sebanyak RM745,480 bagi Tahun Taksiran 2000 bukan merupakan bonus dan dengan itu bayaran tersebut adalah dibenarkan sebagai tolakan sepenuhnya di bawah Seksyen 33(1), Akta Cukai Pendapatan 1967.

Issue For Determination

[3] The single issue formulated for determination before the Special Commissioners of Income Tax (the SCIT) and now before this court is as follows:

> Whether the Appellant is correct in treating the incentive payment of RM745,480 made to employees of the Respondent for the Year of Assessment 2000 as bonus and consequently disallowing a deduction of a sum of RM745,480 under section 39(1) (h) of the Income Tax Act 1967 (the Act) in respect of the said incentive payments or whether alternatively the incentive payments of RM745,480 are not bonus and are therefore fully deductible under Section 33(1) of the Act.

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Facts Proved Or Admitted Before The SCIT

[4] Based on the evidence adduced, both oral and documentary, the following facts were admitted or proved before the SCIT:

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4.1 The respondent is a private limited company incorporated on 28 January 1985. The respondent's principal activity is the business of interior design fit outs and renovations for commercial buildings and offices.

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4.2 A field audit was conducted by the appellant on the respondent on 20 and 21 May 2003 and subsequently the appellant issued a Notice of Additional Assessment dated 25 September 2004 against the respondent for the Year of Assessment 2000.

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4.3 The respondent being dissatisfied against the abovementioned assessment lodged an appeal *vide* Form Q dated 18 November 2004, hence this appeal.

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4.4 The incentive payments are separate and distinct from bonus payments and in fact represent remuneration for extra work and services.

4.5 The incentive payments were part of respondent business strategy which was consistently and genuinely applied even before bonus restriction was re-introduced in 1998.

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4.6 The respondent's pay salary, bonus and incentives to their employees. Salary is for a basic payment under the contract of services which the respondent is obligated to pay on a monthly basis. Bonus is for job considered well done and is also dependant *inter alia* on whether the company has made profits and whether market conditions are good. Incentive is given to employees for securing sales and collections and to promote a sales and revenue driven culture within the workforce irrespective of their actual duties.

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4.7 The incentive system was formalised at the meeting of the board of directors as follows:

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(a) Minutes of board of directors' meeting dated – 16 November 1998;

(b) Minutes of board of directors' meeting dated – 7 December 1998;

(c) Minutes of boards of directors' meeting dated – 13 December 1999.

4.8 The need for formalisation of the incentive payments were driven by the economic conditions in 1998 and but did not present any shift in a consistent and genuine policy and strategy adopted by the respondent.

4.9 Incentive payment is not bonus because it is not a payment added to what is usual. It is a payment for doing something different or something extra.

Duty Of The Court

[5] Before proceeding further, it is important to set out the principles of law regarding the duty of the court when hearing appeals from commissioners in tax cases. In the case of *Lower Perak Co-operative Housing Society Berhad v. Ketua Pengarah Hasil Dalam Negeri* [1994] 3 CLJ 541; [1994] 3 BLJ 265, the Supreme Court has adopted the principles as laid down in *Edwards v. Bairstow* as follows:

> When the case comes before the court it is the duty to examine the determination having regard to its knowledge of the relevant law. If the case contains anything ex facie which is bad law and which bears upon the determination, it is, obviously, erroneous in point of law. But, without any such misconception appearing ex facie, it may be that the facts found are such that no person acting judicially and properly instructed as to the relevant law could have come to the determination under appeal. In those circumstances, too, the court must intervene. It has no option but to assume that there has been some misconception of the law and that this has been responsible for the determination. So, there, too, there has been error in point of law.

[6] The court in *Lower Perak*'s case further refer to the case of *Chua Lip Kong v. Director-General of Inland Revenue* [1981] 1 LNS 157. The relevant passage is as follows:

A … it is plainly wrong in law; or else it is a conclusion of mixed fact and law that no reasonable special commissioners could have reached if they had correctly directed themselves in law. Whichever way it is looked at, it falls within wellknown principal laid down by Viscount Radcliffe in *Edwards v. Bairstow*. It is a conclusion or decision of the special commissioners which the High Court was entitled to and ought to have set aside.

[7] In *Lim Foo Yong Sdn Bhd v. The Comptroller-General Of Inland Revenue* [1986] 2 CLJ 182; [1986] CLJ (Rep) 1, when delivering the unanimous judgment of the Privy Council, Lord Oliver indicated in what circumstances a court might interfere with the decision of the special commissioners. Here is what his Lordship said (at pp 11-12):

> The special commissioners are of course, as the Federal Court rightly observed, the judges of fact, but in finding the facts and drawing the inferences of secondary facts from them, they must not misdirect themselves and they must draw conclusions from facts having probative value. In their lordships' judgment, the special commissioners in this case both misdirected themselves by reaching conclusions inconsistent with primary facts found by them and drew inferences from matters which were of no probative value in supporting their conclusions.

[8] The following passage in the case of *Mamor Sdn Bhd v. Director-General Of Inland Revenue* [1979] 1 LNS 145; [1981] 1 MLJ 117 at p. 118 is also relevant in determining the role of the High court in this appeal. There, the court had this to say:

> It has been argued that the deciding order of the Special Commissioners is entirely based on findings of facts and as such the court cannot interfere with the decision made on such findings by the Special Commissioners. With respect I am of the opinion that it is open for the High Court to review the decision of the Special Commissioners, if the Special Commissioners:
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> (i) misdirect themselves on the law; or
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> (ii) answer the wrong question; or
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> (iii) omit to answer a question which they ought to have answered; or
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> (iv) took into account factors which they ought not to have; or

(v) reached a conclusion on the facts which is not supported by the evidence before them; or

(vi) made a finding of facts which no reasonable person in the circumstances would have arrived at.

Appellant's Submission

[9] The crux of the appellant's submission is that the SCIT had erred in law and fact in holding that the payment of RM745,480 is an incentive payment and not bonus paid by respondent to its employees. The so-called "incentive payments" was in actual fact a bonus paid to the recipients for doing and/or carrying out their normal duties and there were no extra duties and/or jobs performed by them. Therefore, the payment is caught under s. 39(1)(h) of the Income Tax Act 1967.

[10] Section 39(1)(h) of the Act reads as follows:

> 39(1) Subject to any express provision of this Act, in ascertaining the adjusted income of any person from any source for the basis period for a year of assessment no deduction from the gross income from that source that period shall be allowed in respect of:
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> (a) -(g) (not applicable)
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> (h) any sums paid by way of bonus to an employee in excess of two twelfths of his wages or salary.

[11] According to the appellant, the term "bonus" is not defined by the statute. In the absence of a statutory definition, the words of a statute should be accorded their usual and ordinary meaning. In the case of *Director-General Of Inland Revenue v. Highlands Malaya Plantations Ltd* [1988] 1 LNS 145, the court has adopted the definition of "bonus" given in the New English Dictionary as follows:

> a boon or gift over and above what is normally due as remuneration to the receiver, and which is therefore something wholly to the good.

[12] To determine whether a payment is a bonus, we have to go behind the label and seek its true character. Therefore, the label or what the parties call the payment is not conclusive of what the payment is and the true nature or character of the payment will

A determine what it is. (see *Director-General Of Inland Revenue v. Harrisons & Crosfield (M) Sdn Bhd* [1988] 2 CLJ 1; [1988] 1 CLJ (Rep) 34). The appellant contends that in the instant case, the respondent's characterization of the payment as "incentive" is not genuine and such payment was used as a cloak and/or a
B smokescreen for bonus payment.

[13] The conclusion reached the SCIT that the payment was made for extra work and services provided by the respondent's staff and the incentive payments were actually separate and
C distinct from bonus payment could not be supported by the facts proved or admitted before the SCIT. The SCIT failed to explain what are the extra duties and/or works performed by the respondent's staff and what are the distinctions of the so-called "incentive payments" from bonus in the CS.

D **Respondent's Submission**

[14] The crux of the respondent's submission is that the incentive payments cannot be regarded as bonus and are fully deductible under s. 33(1) of the Act.

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[15] According to the respondent, it is trite law that bonus is a boon or gift over what is normally due as remuneration and therefore payment for additional work can never be rightfully seen as a bonus. The SCIT came to the factual conclusion that the
F incentive payments were for extra work and services and therefore not a bonus. This is clearly stated in paragraph (ix) of the case stated. This factual conclusion is based on the relevant evidence adduced. There is no requirement for the SCIT to state the evidence in the case stated (CS).

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[16] Further, in so far as oral evidence is concerned, the SCIT as the trial judge of the matter is entitled to assess the probative value of the evidence adduced by both parties. An appellate court is not in a position to assess the probative value of such evidence. The SCIT clearly state their rightful findings of facts. These are
H made further to evidence available. It cannot be said that no reasonable person in the circumstances would have arrived at the conclusions made by the SCIT. The decision of the SCIT is final, even though this court might not, on the materials, come to the same conclusion.

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Findings Of The Court

[17] I am in full agreement with the submission of the appellant that in the circumstances of this case the incentive payments cannot be regarded as bonus and are fully deductible under s. 33(1) of the Act.

[18] Given that a bonus is a boon or gift over what is normally due as remuneration, payment for additional work can never be rightfully seen as a bonus. This is discussed in detail in *HEH Sdn Bhd v. Ketua Pengarah Hasil Dalam Negeri* [1995] 2 MSTC 2194. In this case, a Managing Director and Finance Director of the appellant were required to do sales and it was resolved that an "incentive allowance" of 12.5% based on net profit before tax will be paid to them. These "incentive payments" were in addition to the salaries and bonuses for their respective posts as Managing Director and Finance Director. The directors were paid the "incentive allowance" for doing sales activities, ie, doing services or extra work which was additional to and beyond the call of their normal duties. Evidence adduced showed that they were not paid any salary for doing the extra work as salesmen. It was held that the payment made to the Managing Director and Finance Director was commission amounting to deductible expenditure within the meaning of s. 33(1) of the Act and was not a bonus payment subject to restriction under s. 39(1)(h) of the Act. In this regard, the Special Commissioners held in the case that:

> In the case of *Director General of Inland Revenue v. Highlands Malaya Plantations Ltd* it is clear that the "additional remuneration" was in truth an addition to wages and also contractual. It was paid under the scheme which had been clearly been expressed by the employer to be a bonus scheme from the beginning and was paid to the managerial staff for doing their normal duties in accordance with their "standard letters of appointment". It must be noted that it was not paid for any extra work done or services rendered by the managerial staff beyond the call of their standard "letter of appointment".
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> In the case of *Director-General Of Inland Revenue v. Harrisons & Crosfield (M) Sdn Bhd* [1988] 2 CLJ 1; [1988] 1 CLJ (Rep) 34 the issue was whether or not the additional remuneration paid to the senior executives and the managerial staff under the additional remuneration scheme was a bonus in character … The Supreme Court held that it was a bonus in character. Just as in *Director-*

A *General Of Inland Revenue v. Highlands Malaya Plantations Ltd* [1988] 1 LNS 145, the "additional remuneration" given to the managerial staff and the senior executives in the case of *Director-General Of Inland Revenue v. Harrisons & Crosfield (M) Sdn Bhd* [1988] 2 CLJ 1; [1988] 1 CLJ (Rep) 34 was also paid for doing their normal duties and not for doing any specific extra job or specific extra services rendered beyond the call of their standard "letter of appointment".

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It is thus manifestly patent that in both Supreme Court cases referred to the payment to managerial Staff, which were held to be bonus payments, were given in addition to the salaries that they were paid for performing a specified duty. The payments were not made in respect of performing duties for which they received no other remuneration... Therein lies the distinction between a "commission" and a "bonus".

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D On the evidence adduced it is our firm finding of fact that the payment made to the two directors was specifically made for doing something in addition to their normal duties... What they did was a service given to the Company which they could not have been compelled to do and for which the only remuneration they received was the "additional sales commission".

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[19] Whether or not a payment is a bonus is a question to be resolved in light of the relevant facts. The relevant facts were considered by the SCIT whereby the SCIT stated that (pp. 8 and 11 of the CS):

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Having heard the facts, the evidence adduced and the submissions of both parties and having read the documentary exhibits tendered and the authorities cited our findings are as follows – ...

G The appellant made an incentive payment of RM745,480 to three of its senior staff for extra work and services provided by them. Evidence shows that the true character of the said incentive payments actually is separate and distinct from bonus payment...

H Based on the above, it is clear that the incentive payments made by the appellant should not be considered as bonus payments as they are in no way "a boon or a gift over" and are instead remuneration for extra services and duties. The facts presented clearly show the purpose and the method of calculation of the incentive paid.

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[20] In arriving at the conclusion that the incentive payments were made to the employees of the respondent for extra work and services provided by the employees and hence are not bonus payments, the SCIT have correctly applied the principles stated in the case of *Director General of Inland Revenue v. Highlands Malaya Plantations Ltd (supra)* that the incentive payments are not "a boon or gift over and above what is normally due as remuneration to the receiver".

[21] The decision of the SCIT is consistent with the following judgment of Supreme Court in *Director General of Inland Revenue v Harrisons & Crosfield (M) Sdn Bhd* [1988] *(supra)*, which was argued before the SCIT at the hearing:

> To determine whether a payment is a bonus, we have to go behind the label and seek its true character. To determine the character … it would be useful to begin with the sample of letters of appointment …

[22] Further, "incentive" ordinarily means "serving to encourage, rouse, or move to action … designed to enhance or improve production" (see *Webster's Third New International Dictionary* 1141 (1981)). The respondent paid "incentive payments" to its employees for securing sales and collections and to promote a sales and revenue-driven culture within the workforce irrespective of their actual duties. This is the policy of the respondent which was formalised by the meetings of the board of directors. It is not difficult to see such a business strategy as "incentive" in that it rewards the staff who have performed duties over and above what is required of them.

[23] In arriving at their conclusion, the SCIT had full recourse to all relevant documents and information including:

(a) The employment contracts of each of the recipients of the incentive payment on pp. 90 to 99 of exh. D;

(b) Detailed witness testimony of each of the recipients of the incentive payment who described what additional work they did;

(c) The detailed workings on how the exact quantum of the incentive payment was calculated for each of the recipients; and

A (d) The strategy, purpose and object behind the incentive payments as described by RW1, the Managing Director of the respondent.

[24] Further, the statement of agreed facts clearly shows the B history of all the resolutions on the incentive payment and acknowledgement that the incentive payments have been made in accordance with such resolutions. Therefore, there are no gaps in the case and the SCIT cannot be said to have reached a conclusion on the facts which is not supported by the evidence C before them; or made a finding of facts which no reasonable person in the circumstances would have arrived at.

[25] There are sufficient evidence, both oral and documentary, before the SCIT in deciding that the recipients have performed D duties over and above what is required of them and they expected payment for the same. These evidence, *inter alia*, are as follows:

(a) The incentive payments were given for doing sales and marketing, a type of work which is different and additional to each incentive payment recipient's scope of duty;

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(b) the respondent pays both bonus and incentives and in substance, such payments are separate and distinct in nature. Bonus is for a job considered well done and is also dependant *inter alia* on whether the respondent has made profits and F whether market conditions are good. The respondent has applied s. 39(1)(h) of the Act to bonus payments made. Incentive is given to employees for securing sales and collections and to promote a sales culture within the workforce irrespective of their actual duties. Incentive G payments are not subject to the restriction in s. 39(1)(h) of the Act;

(c) the respondent has paid incentive payments along with bonus payments even prior to bonus restriction being imposed under H s. 39(1)(h) of the Act. Therefore, the respondent's characterization of "incentive" and "bonus" payments and their distinguishing features are patently genuine and is clearly not meant as a means for avoiding the restriction in s. 39(1)(h) of the Act; and

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(d) as part of its business strategy, the respondent does not have a specialized marketing department. To encourage and reward senior management (who are essentially technical people) to perform sales and collections functions (which are not part of their contractual duties), incentives have to be paid.

Conclusion

[26] Having considered:

(i) the duty of the High Court as stated in the above cases;

(ii) the oral and documentary evidence adduced at the hearing before the SCIT;

(iii) the Facts Admitted and Proved at the hearing before the SCIT;

(iv) the decision of the SCIT; and

(v) the appellant and respondent's submissions herein,

the court is of the considered opinion that no appellate intervention is warranted in this appeal.

[27] In the upshot, I would dismiss this appeal with costs and the decision of SCIT is affirmed.